No. 15164

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

Glens Falls Indemnity Company, a Corporation, and E. F. Grandy, Inc.,

Appellants,

vs.

American Seating Company, a Corporation,

Appellee.

APPELLANTS' SUPPLEMENTAL REPLY BRIEF.

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I.

Appellee Has Conceded That Two Statements of Fact Heretofore Made in Its Briefs Are Erroneous and Unsupported by the Record. (This Relates to Part III, Pages 7-8 of Appellee's Supplemental Answering Brief.)

Appellee now concedes that the record does not support its often-repeated claim that the subcontract specifications required the subcontractor V. L. Murphy to obtain certain material from Appellee. The material referred to is the material which Appellee did supply to the subcontractor and for which Appellee was never paid, although Appellant Grandy paid the full subcontract price, which included the materials. Appellee now wants Appellant Grandy to pay for those materials again.

Appellee now says that the materials in question would have to be purchased from a supplier "such as Appellee." This is true in the sense that just as bricks must be purchased from a brickyard, chemical sinks, tables and fume hoods must be purchased from a manufacturer

thereof. Appellee, American Seating Company was such a manufacturer and it got the business from the subcontractor.

This leads to the second error which was that Appellant Grandy forwarded the purchase order for the equipment to Appellee American Seating Company. A partial correction of this error has been tendered. Appellee has conceded that Grandy did *not* forward the purchase order to Murphy. They now say that Grandy forwarded the purchase order to the Naval Officer in charge of construction. The truth is that Murphy sent the order to American Seating, with a copy to Grandy [R. 81-82]. Grandy sent copies to the Naval Officer in charge of construction [R. 163]. This true state of the record has heretofore been carefully detailed at page 8 of Appellants' Opening Brief and at pages 1 and 2 of Appellants' Reply Brief.

These erroneous statements were used as a premise which was the foundation for the argument that Grandy was liable to American Seating Company for the purchase price of these materials. This premise is now admittedly false. The importance of this point is that the false premise was carried over into the findings. It must be amply clear that finding of fact 6 [R. 39] is false and unsupported in the part which reads as follows:

> "6. That it is true as alleged in Paragraph VI of the Complaint that the defendants, E. F. Grandy, Inc. and Glens Falls Indemnity Company, knew that in order for said V. L. Murphy to carry out his contract, it would be and was necessary for him to purchase and obtain supplies and materials from plaintiff."

Since this error of argument was accepted by the trial court and perpetuated in the findings, it is reasonable to believe that the judgment rests upon this crumbly foundation.

II.

There Is No Evidence That Grandy Was Contractually Liable to Appellee American Seating. (This Is Responsive to Part V-A, Pages 8-10, of Appellee's Supplemental Answering Brief.)

All of the evidence, as it is carefully accumulated at pages 8-9 of Appellee's Supplemental Answering Brief, indicates nothing more than that Grandy knew the source of materials purchased by Murphy because Murphy told him and that Grandy watched the progress of the work on the job and did what he could to expedite it.

No responsibility to American Seating fell upon Grandy because of a suggestion that Murphy might borrow money by hypothecating his subcontract. Nothing appears in the record but the fact that Murphy needed money at this time. Grandy told him how he might get some. Murphy took the suggestion. Grandy was advised by the bank of the hypothecation and honored notice to make future payments to the bank.

Such banking transactions by contractors and subcontractors are so common as to be considered almost customary. That suggesting a common method of financing and honoring a proper notice of assignment of proceeds of a contract should make the person so doing liable to creditors of the assignor, is a contention without precedent or authority. Needless to say, none is cited.

True, there is no evidence that Grandy ever demanded a statement from the assignee bank or from the subcontractor that American Seating had been paid. On the other hand, there is no evidence that American Seating ever advised the contractor, Grandy, that it had not been paid. The interesting connecting link between what has been said before in Appellants' briefs about the contractor's Miller Act bond and also, for that matter, the only application of Article 6(d) of the Prime Contract, now appears.

Article 6(d) authorizes the Government to hold up payments to the contractor if there are "any unsettled claims against the Contractor for labor and materials." Of course, American Seating made no claim [R. 143]. American Seating sued Murphy and recovered a judgment [R. 31]. The possibility of recovering from Grandy or Murphy's surety seems to have been an after thought. A timely notice to the contractor would have protected the rights of American Seating under Article 6(d) and the Miller Act. Further discussion of this subject at this point would be out of context because the Appellee's argument that there is either an implied in fact or in law contract rests upon the parts of the record just previously discussed.

Murphy was an independent contractor. He was related to Grandy only as specified in the subcontract. Grandy had no right to know what Murphy did with the money Grandy paid to him. Grandy was legally a stranger to Murphy's suppliers and had no obligation to pay them.

> *Llewellyn Iron Wks. v. Reed* (1932), 123 Cal. App. 607, 612, 11 P. 2d 657;
>
> *Kruse v. Wilson* (1906), 3 Cal. App. 91, 84 Pac. 442.

III.

There Is No Legal Foundation for the Assertion That Grandy Is Contractually Liable to Appellee. (This Is Responsive to Part VI-B, Page 15, of Appellee's Supplemental Answering Brief.)

The factual misstatements which we had hoped might be laid to rest are still the foundation of Appellee's argument on page 15 of Appellee's Supplemental Answering Brief. There it is argued that Grandy *requested* the materials. All of the evidence in the record is contrary to this statement. Murphy requested the materials by purchase order.

The next misstatement is that Grandy *received* the materials. The Government received the materials. There is no evidence in the record to support the proposition that Grandy received the materials in any sense. The record shows only that the materials were delivered to the job by American Seating and installed in the work by Murphy. It is, of course, true that the contract had to be performed according to schedule before the Government would pay on schedule, but to say that Grandy requested or received the material from American Seating is contrary to fact.

The statement that Grandy implied that American Seating would receive a share of the funds which Grandy expected to receive from the Government is utterly without support of evidence or inference.

Appellee's argument that the law will imply a promise by a prime contractor to pay his subcontractor's supplier (on the theory that the prime contractor has received the benefit) has been rejected by the California courts. The law will not imply such a promise.

> *Llewellyn Iron Wks. v. Reed* (1932), 123 Cal. App. 607, 612, 11 P. 2d 657;
>
> *Kruse v. Wilson* (1906), 3 Cal. App. 91, 84 Pac. 442.

As authority to support its argument, Appellee tenders two code sections. Both of them have been frequently cited in the decisions of Appellate Courts, but no decisions are cited in Appellee's brief for reasons which the slightest research discloses.

Section 1589 of the Civil Code has no application to the case at bar. The reason is succinctly expressed in the case of *Fruitvale Canning Co. v. Cotton* (1953), 115 Cal. App. 2d 622, 626, 252 P. 2d 953, 955, in the following words:

> ". . . This section, however, has generally been held to apply only where the person accepting the

benefit was a party to the original transaction. (*Canale v. Copello,* 137 Cal. 22, 25 (69 P. 698); *Stone v. Owens,* 105 Cal. 292, 296 (38 P. 726); *Tarpey v. Curran,* 67 Cal. App. 575, 587 (228 P. 62); *Beazley v. Embree,* 41 Cal. App. 706 (183 P. 298).) Defendants were not parties to that agreement."

The court flatly held that the defendants in that case were not parties to the original contract and that, therefore, Civil Code Section 1589 had no application.

Section 3521 of the Civil Code of California is an equitable maxim which must be given a reasonable interpretation (*Bruce Estate* (1938), 27 Cal. App. 2d 44, 80 P. 2d 82). It has been applied to contract actions to prevent a party from accepting the benefits of a contract, but avoiding its obligations by rescission (*Neet v. Holmes* (1944), 25 Cal. 2d 447, 154 P. 2d 854).

Applying the principles of the section to the case at bar would find Murphy liable. He got the benefit from American Seating, but avoided the correlative burden for he received the full subcontract price from Grandy but neglected to pay American Seating. But American Seating already has a judgment against Murphy.

The section doesn't fit Grandy, because Grandy paid full price to Murphy for whatever benefit was received from American Seating's materials. This was according to his contract with Murphy. The materials were actually supplied by Murphy so far as Grandy was concerned.

Would it be reasonable to apply such a maxim to require Grandy to pay twice? It would seem more reasonable to let American Seating bear the brunt of its own credit risk which has since proven to be so ill advised.

IV.

Since the Only Claim Against Grandy Is That Liability Is Implied in Fact or in Law From Grandy's Conduct and Not From the Subcontract or Murphy's Bonds, Joint Liability With the Bonding Company Does Not Exist and a Joint Judgment Is Error.

One of the common defenses in cases of suretyship is that the contract was changed without the consent of the surety. Where this is established to be the fact, the surety is exonerated.

> Civil Code, Sec. 2819;
>
> *People v. Fidelity & Deposit Co. of Md.* (1938), 28 Cal. App. 2d 325, 82 P. 2d 495;
>
> *Shuey v. Bunney* (1935), 4 Cal. App. 2d 408, 40 P. 2d 859.

The rationale of this principle is that the surety has agreed to be bound to the performance of a certain contract. If this contract is changed, it is in effect a different contract to which the surety is not bound.

This familiar principle is applicable to the case at bar but in even simpler form. Glens Falls agreed to act as Murphy's surety with respect to the subcontract only. This subcontract incorporated the prime contract so far as it was applicable. It was then foreseeable that Murphy might not pay his suppliers and that they could avail themselves of the Miller Act bond required of Grandy who was a principal thereon and that consequently Grandy might have to pay the material suppliers. In such event Glens Falls agreed to indemnify Grandy.

Care must be taken to distinguish between a loss suffered by Grandy in the fashion above described and a loss which Grandy might incur by other contracts. For example, if Grandy agreed to purchase extra material from American Seating and in due course was forced

to pay for it, no one would contend that Glens Falls should have to indemnify Grandy. This was something which Grandy did on its own hook and Glens Falls was in no way involved. It was a separate contract.

In settling whether or not the subcontract surety must indemnify the contractor in a given case, the decision does not turn on the *kind* of obligation involved, but rather on the *source* of the loss. If the subcontract is the source, then the surety is bound to indemnify the contractor. However, if the source of the loss is any other obligation, the surety is not responsible.

> *Llewellyn Iron Wks. v. Reed* (1932), 123 Cal. App. 607, 612, 11 P. 2d 657.

In the instant case, American Seating bases its claims against Grandy upon liability implied in fact or implied in law from the conduct of Grandy in relation to American Seating. This does not depend upon the subcontract and Appellee does not assert that it does.

Bearing in mind this distinction, the claim against Grandy is clearly different from the claim against Glens Falls because they come from different sources. They are independent obligations, if they exist at all. The obligations are not joint and the joint judgment results from a misconception of the basis of liability and is error.

The real importance of this point is that Glens Falls agreed to indemnify Grandy for losses which have their source in the subcontract. Glens Falls did not agree to be responsible for losses the source of which is Grandy's independent and possibly improvident commitments, express or implied.

This points up the very real fact that the two Appellants are independent Appellants, the interests of which are in conflict to the extent stated. For this reason, separate supersedeas bonds were posted [R. 60, 62; Supp. R. 31, 35].

The claim against Grandy must stand or fall alone; and, as pointed out, it is completely alone, in fact, without support from the record.

By a process of elimination the claims against Glens Falls come down to reliance upon the Payment Bond. This is an indemnity bond against loss suffered by Grandy, the source of which must be the subcontract. As the logic of the situation unfolds, it is apparent that there is no claim that Grandy has suffered loss (or even that it has liability) which is traceable to the subcontract as its source. So a judgment against Glens Falls is unsupported in fact and law. The same must again be said of the judgment against Grandy.

V.

The California Cases Are Explicit and Uniform in Holding That Where There Is a Performance Bond and a Payment Bond, Persons Supplying Material to a Subcontractor Cannot Recover on the Performance Bond. (This Supplements the Argument in Appellant's Original Opening Brief, Page 36, and Is Responsive to Point VI-C of Appellee's Supplemental Answering Brief.)

Lamson Co., Inc. v. Jones (1933), 134 Cal. App. 89, 91-92, 24 P. 2d 845 and *Summerbell v. Weller* (1930), 110 Cal. App. 406, 294 Pac. 414, are authority for the point made in the above caption. They cite *Maryland Casualty Co. v. Shafer* (1922), 57 Cal. App. 580, 208 Pac. 192, wherein appears a full discussion of this established principle:

> "It is contended that the plaintiff is liable under the faithful performance bond for the claim of Thompson Brothers. In support of such contention the following cases are cited: *French v. Farmer*, 178 Cal. 218 (172 Pac. 1102); *Fuller v. Alturas School Dist.*, 28 Cal. App. 609 (153 Pac. 743);

Callan v. Empire State Surety Co., 20 Cal. App. 483 (129 Pac. 978, 981). If the faithful performance bond were the only one furnished, appellant's position would seem to be invulnerable, but the contract required and Shafer and the plaintiff executed a separate bond in express compliance with the requirements of the act of 1897 (Stats. 1897, p. 201), and acts amendatory thereof, entitled 'An act to secure the payment of the claims of materialmen, mechanics, or laborers, employed by contractors upon state, municipal or other public work.'

"Liability under a contract of suretyship, as under other contracts, is dependent upon the intention of the parties thereto. In the discussion of a similar question in *French v. Farmer, supra,* it is said: 'If . . . any effect whatever is to be given to this clause in the condition of the bond, it must be held that it was the intention of the parties to benefit such third persons. . . . The courts of Nebraska, Missouri, Iowa, Indiana, and Michigan seem to hold to the view that if it can be fairly said from either the contract or the bond, which are to be construed together, that the parties intended to and did agree to pay such third persons, a suit could be brought on such bond by such third person to recover upon the promise so made for his benefit.' *Here, in compliance with the contract and the statute, a separate bond was given to secure payment of claims of the character under consideration and it would be unreasonable to hold that the parties intended the faithful performance bond to secure the same claims.* The Statute of 1897 (as amended by Stats. 1911, p. 1422) provides that the claimants 'shall, within ninety days from the time such contract is completed, file with the . . . board of supervisors . . . a verified statement of such claim.' Concededly appel-

> lant failed to file such a claim and is therefore precluded from recovering on the bond given pursuant to the requirements of that statute. Such failure affords no ground for relief under the faithful performance bond manifestly intended for a different purpose." (57 Cal. App. 580, 582.) (Emphasis added.)

While Appellee sounds a derisive note on the question of the value of ascertaining the intention of the parties in connection with this problem, it should be remembered that the matter of intention is common to all contracts (*United Airlines, Inc. v. Western Airlines* (1955), 132 Cal. App. 2d 308, 282 P. 2d 118, holding that indemnity agreements like other contracts are to be interpreted so as to give effect to the mutual intention of the parties, citing Civ. Code, Sec. 1636). The court expressly recognizes this legal concept in the foregoing quotation. It is a matter of interest to observe that it was Appellee American Seating which asked E. F. Grandy to state his purpose in requiring Murphy to furnish the payment bond. His reply was that it was required to protect Grandy against loss, and no one else [R. 22, 27].

Appellee has misconstrued Professor Corbin's view of the importance of ascertaining the intention of the parties. This is probably due to the fact that the quotation from the case of *Socony-Vacuum Oil Co. v. Continental Casualty Co.* (C. A. 2d, 1955), 219 F. 2d 645, which appears on page 18 of Appellee's Supplemental Answering Brief, is not properly punctuated. Professor Corbin's comment is an inside quote which should stop at the end of the next to the last sentence. The balance of the quotation is the court's comment in ascertaining the law of the State of Vermont in the absence of any decision of the courts of that state and in the absence of statute on the subject. Moreover, there was only one bond which expressly required the subcontractor to "pay all labor and material obligations."

The decision in the case at bar must be made in quite different circumstances because the law of the State of California has already been declared by the Legislature and the courts of California. It is, of course, the duty of this Honorable Court to apply the law of the State of California as so declared.

Coming back to Professor Corbin's words, and to put them in the right context, the paragraph immediately following the one quoted in the *Socony-Vacuum Oil* case reads as follows:

> "A 'simpler' question, but not always a simple one. There will continue to be badly drawn bonds, although clarifying the law would tend toward improvement in draftsmanship. A fair share of the past litigation has been due to doubtful interpretation; such litigation cannot altogether be avoided. Nor is it meant that 'intention to benefit' can be wholly eliminated from third party beneficiary law. It is merely asserted that in the case of a surety bond for the payment of money, if there is a promise to pay money to an ascertainable person, the fact that he is a third person who gave no consideration for the promise does not prevent him from enforcing it. The fact that he was not identified at the time of making the contract does not prevent him from being 'ascertainable' at the time of performance." (4 Corbin on Contracts 164.)

To complete the point that Professor Corbin recognizes that sound principles are not violated by the position taken by Appellants in this action on the point presently under discussion and others, we quote from Section 800 of the same work:

> "A promise to indemnify the promisee against loss is one that could be fully performed, in many instances, without paying anything to the third persons.

> Even if they have power to put a lien on the promisee's property, they may not do so in fact, or the lien that is put on may be disposed of otherwise than by paying the debt. Such a promise therefore cannot surely be said to have been 'intended' for the benefit of the third persons, since the promised performance will not necessarily benefit them. And to give the third party a judgment for his debt would often compel the surety to do more than he promised to do.
>
> "If on reasonable interpretation the surety bond contains no promise to pay laborers and materialmen, of course they have no right against the surety. There are numerous cases, even in states where the rights of third party beneficiaries are fully recognized, holding that the particular bond in suit contained no promise to pay the third parties who were suing." (4 Corbin on Contracts 174.)

In the first quotation above Professor Corbin urges clarifying the law of interpretation of surety contracts. This may be done by court construction or more directly by statute. It is implicit in Professor Corbin's discussion that such contracts must be construed according to the law when thus established. California decisions above cited leave no doubt as to the law of California. Where in compliance with the contract a performance bond *and* a payment bond are given, persons supplying materials cannot recover on the performance bond because a contract is to be interpreted according to what the parties intended.

As heretofore pointed out in Appellants' Opening Brief and in Appellants' Supplemental Opening Brief, the intention of the parties to the subcontract is clearly ascertainable. The answer to interrogatory 27 [R. 22] and to request for admissions 4 [R. 27] affirm it. The two bonds were given to protect the contractor, and no one else. It was unnecessary to have solicitude for the ma-

terialmen because they were already amply protected by the Miller Act bond of the prime contractor, GRANDY. GRANDY, alone, was faced with the risk of loss, and he required the bonds as protection.

It is significant that there is no provision in the performance bond which provides that it is for the use or benefit of materialmen. The only way that any benefit to materialmen may be "read into the bond" is by implication and for this purpose Appellee's sole reliance is upon *Pacific States Co. v. Fidelity & G. Co.* (1930), 109 Cal. App. 691, 293 Pac. 812.

The *Pacific States* case is very different and the rationale of the court very clear. The court looked to the *intention* of the parties and quoted with approval the reasoning from another case at page 694 of the California report, as follows:

> ". . . 'The true meaning and intent of the provision requiring the contractor to furnish materials was certainly that he should pay for them, and not that he should simply supply them and leave respondent to pay for them. This is the only reasonable deduction from such an agreement.' "

By his agreement with the owners and according to statute, the contractor in the *Pacific States* case had posted a bond to guarantee payment of all materialmen. Persons who supplied materials to a subcontractor could sue the contractor on this bond. The contractor in turn exacted a *single* bond from his subcontractor. Obviously, the contractor had to look to that bond alone for his protection.

The court concluded that the contractor must have intended protection against claims of materialmen which the contractor would otherwise have to pay and that therefore the bond was not designed exclusively to guarantee completion of the work, but also to guarantee that the

subcontractor would pay the claims of his suppliers for the protection of the contractor.

Having thus determined that the bond was intended to assure payment to the suppliers of material, they were entitled to sue on the bond. Bear in mind that the reason for implying the promise to pay material suppliers is that otherwise the contractor would not have received protection against having to pay the claims himself and this was the very thing which the bond was intended to furnish.

In the case before this court, the danger of loss to Grandy, the contractor, due to the failure of the subcontractor to pay materialmen was the subject of a separate obligation of the surety (the Payment Bond), which was entirely adequate for this purpose. The reason for the ruling in the *Pacific States* case is therefore entirely lacking in the case at bar. It is a familiar axiom that when the determination in the *Pacific States* case of intention of parties to a particular contract may be considered to be a rule at all.

> "When the reason of a rule ceases, so should the rule itself." (Civ. Code, Sec. 3510.)

The *Pacific States* case is not in conflict with nor an exception to the rule that where there is a performance bond and a payment bond, persons supplying materials to a subcontractor cannot recover on the performance bond which is not expressly for their benefit. This is a general rule recognized expressly in *Daniel-Morris Co. v. Glens Falls Indemnity Company* (1955), 308 N. Y. 464, 126 N. E. 2d 750, 752, and by Professor Corbin on page 25 of the 1956 Pocket Part to 4 Corbin on Contracts.

Where there is plainly stated obligation, such as in the *Socony-Vacuum* case, there is no need to imply a promise to pay materialmen as was necessary to reach the conclusion of the *Pacific States* case. And it seems odd to quote with emphasis from the *Socony-Vacuum* case. (App.

Supp. Ans. Br. p. 20) that "it is an unfortunate doctrine to modify the scope of a plainly stated written obligation in a private bond by the supposed motive of the obligee . . ." when Appellee's objective is to accomplish that very purpose by implying an obligation of payment in a performance bond when a payment bond was furnished at the same time and in the same transaction.

The rule that the performance bond is not available to Appellee stands unimpeached by any authority.

VI.

None of the Authorities Cited by Appellee Are Authority for Recovery Against the Performance Bond. (This Is Responsive to Point VI-C of Appellee's Supplemental Answering Brief.)

A. Pacific States Co. v. U. S. Fidelity and G. Co. Does Not Construe a Performance Bond.

The reasoning and application of the *Pacific States* case was discussed in Section V of this brief and what was said there will not be repeated. *The California Supreme Court did not decide the Pacific States case!* Hearing in the Supreme Court was not even requested. We still don't know what that court would say in the circumstances. The cases decided in 109 California Reports were decided in 1895. The *Pacific States* case was decided by the District Court of Appeal in 1930.

It involved a single all purpose bond—not a performance bond. It did not hold that the performance bond in this case includes a promise to pay materialmen as Appellee claims on pages 20, 21 and 22 of its Supplemental Brief. The Supreme Court of this State has *not* held that the language of *any* performance bond by implication included a promise to pay materialmen as claimed by Appellee in its Supplemental Brief, page 22. Neither does the *Socony-Vacuum* case involve even the

same problem as the *Pacific States* case. Professor Corbin does not cite it.

Appellee's argument lacks logical application of authority. A cursory reading of the *Pacific States* case lays plain the fact that the bond involved was not a performance bond, but a single all purpose bond. More than that, it reveals that the case was not decided according to the plain language of the bond, but upon the ascertainable intent of the parties in the light of the circumstances of the case. It does not purport to lay down a rule of law for performance bonds.

B. The Socony-Vacuum Case Does Not Involve the Problem of the Pacific States Case.

A single all purpose bond is involved in the *Socony-Vacuum* case as in the *Pacific States* case. There the similarity ends because the former involves a bond where the obligation is that the subcontractor "shall pay all labor and material obligations" while the obligation in the latter is limited in that the subcontractor "shall well and faithfully keep and perform all of the covenants and agreements of said contract."

The California court would have had no difficulty in deciding that the materialmen could sue under the terms of the bond in the *Socony-Vacuum* case, but there is no way of telling how the United States Court of Appeals for the Second Circuit would have ruled had the bond in the Vermont case been conditional upon performance alone. The doubt is cast by the insistence of the Federal Court that the court should not rewrite the contracts of the parties:

> ". . . Were we to hold otherwise, we should in effect, by substituting a mere contract for indemnity for the bond which was made, be presenting the defendant surety company with an unearned windfall." (219 F. 2d 645, 649.)

C. Both the McGrath Case and the Daniel-Morris Case Involved Payment Bonds. They Do Not Support Appellee's Attempt to Recover on a Performance Bond.

In both of the New York cases above named there were performance bonds. *No suit was filed on these performance bonds for the reason that they were not available to materialmen.* (*Daniel-Morris Co. v. Glens Falls Indemnity Company* (1955), 308 N. Y. 464, 126 N. E. 2d 750, 752.)

Both of these New York cases struggle with the problem of deciding whether the payment bonds are or are not strict contracts of indemnity. In the *McGrath* case the bond was held to be a contract of indemnity against liability. The court explained:

> "This conclusion is not altered by the circumstance that the bond upon which the action is based is conditioned upon payment by the subcontractor of its obligations to laborers and materialmen. This condition merely described the events in which the general contractor could have recourse to the bond, if it were harassed by losses due to neglect of the subcontractor to satisfy these obligations." (*McGrath v. American Surety Company of New York* (1954), 307 N. Y. 552, 122 N. E. 2d 906, 907.)

This decision had to be made in the absence of statute in accordance with principles of the common law as established by judicial precedent. The principle of *strictissimi juris* prevailed in the early cases resulting in construing the intentions of the contracting parties in favor of holding the contracts to be contracts of indemnity.

Daniel-Morris Co. v. Glens Falls Indemnity Company (1955), 308 N. Y. 464, 126 N. E. 2d 750, considered a bond conditioned, "if the Principal shall promptly make payment to all persons supplying labor and material in the prosecution of the work provided for in said contract

. . . then this obligation to be void." The court construed the bond and the subcontract together, as is always done. The subcontract promised materials "free of the lien of any third party." This was obviously not simply a contract of indemnity and the materialmen were allowed to sue the surety directly. The result in each case coincided with the principles for construction of such contracts in the State of New York.

The criticism directed against these cases by Professor Corbin and by the opinion in the *Socony-Vacuum* case was not that they did not conform to the law of New York, but that they did not conform to the weight of modern authority in states where the interpretation of similar contracts is up to the courts and uncontrolled by statute. Professor Corbin points out that the decision in the *McGrath* case makes for circuity of actions by requiring three suits instead of one, although if the liability indemnified against is present, it is certain that the materialman will recover in the end. He thinks that the courts should cut the Gordian knot even at the expense of breaking with precedent.

This criticism has no application to the California law for three reasons: First, it seems unlikely that the California courts would refuse to permit the materialman to sue the surety where the bond is conditioned as in the *McGrath* case. Second, the bonds in the *McGrath* and *Daniel-Morris* cases are bonds against liability and not indemnity bonds against loss or damage. Third, the law of the State of California is established by statute which is strictly adhered to by the courts. (*Thode v. McAmis* (1950), 96 Cal. App. 2d 833, 216 P. 2d 548.)

Where the contract is strictly one of indemnity against loss or damage, Professor Corbin recognizes:

> "A promise to indemnify the promisee against loss is one that could be fully performed, in many in-

> stances, without paying anything to the third persons. . . . Such a promise therefore cannot surely be said to have been 'intended' for the benefit of the third persons, since the promised performance will not necessarily benefit them. And to give the third party a judgment for his debt would often compel the surety to do more than he promised to do." (4 Corbin on Contracts, 174.)

It is this type of bond indemnifying against loss which is before the court in this case and the rule for its construction is established by Civil Code, Section 2778(2). Such a rule is not subject to the objection that the parties are left with any uncertainty as to its meaning for the statute is as much a part of the bond as if written into it. (*Thode v. McAmis* (1950), 96 Cal. App. 2d 833, 216 P. 2d 548.)

VII.

The Payment Bond Is Not Available to Appellee.

There is one reason more compelling than any other why Appellee cannot recover on the payment bond. This reason was not touched upon in the Supplemental Reply Brief of Appellee. It is unanswerable and well established and there is no authority to the contrary.

GRANDY must have actually paid a loss against which he has been indemnified before the surety is liable. No cause of action accrues in favor of Appellee until this has happened. In Section IV of the brief it was pointed out that such a loss could not be sustained by GRANDY at this point or as the result of the within action. But it is an admitted fact that he has not in fact paid such a loss.

California Civil Code, Section 2778, subsection two provides:

> "Upon an indemity against claims, or demands, or damages, or costs, expressly, or in other equivalent

terms, the person indemnified *is not entitled to recover without payment thereof* . . ." (Emphasis added.)

The latest case construing this section is *Thode v. McAmis* (1950), 96 Cal. App. 2d 833, 836, 216 P. 2d 548, wherein the court says:

"We think the bond involved here permits of no such construction as will afford appellants any claim against the insurance company. The language of the bond is clear. It is strictly a contract of indemnity. The language used is apt and free from ambiguity. The insurance company does not undertake or guarantee that the contractor will perform the contract or that liens may not be established against improvements and the ground upon which they are to be constructed, but on the contrary undertakes to indemnify the owner against such loss or damage, if any, as the owner may suffer if the principal does fail or if such liens are finally established. Such a contract affords a remedy to the owner to the extent of such loss only, and only after a loss has been actually paid by the owner. (Civ. Code, Sec. 2778.) This latter condition, of course, expressed in the cited code section, is as much a part of the instrument as though set out therein. Contracts of suretyship are to be interpreted under the same rules to be observed in the case of other contracts. (Civ. Code, Sec. 2837.) The parties to this contract are only the contractor, the owner and the insurance company, and every provision of the contract can be given full application without consideration of any other persons. It results therefore that appellants had no right of action upon this bond."

VIII.

The Trial Court Abused Its Discretion in Denying Appellants' Motion Under Federal Rules of Civil Procedure, Section 60b. (This Section is Responsive to Section II, Pages 3 to 6, Inclusive, and Section VI-A, Pages 11 to 14, Inclusive of Appellee's Supplemental Answering Brief.)

We have deliberately left discussion on this point to the last because it was covered in detail in Appellants' Supplemental Opening Brief and the Appendix thereto. In effect the only answer which has been made to this ground of appeal is to deny that the record shows that the decision of the trial court was made without sufficient understanding of the case.

Such an issue can only be determined by this court by an examination of the proceedings in the trial court. The fact remains that even when the judgment was amended to correct the obvious errors, appropriate modification of the Findings and Conclusions of Law was not permitted. Appellants respectfully submit that the opposition to any reconsideration of the Findings and of the Conclusions of Law was out of fear that a re-examination of the Findings would bring substantial changes to bring them into line with the record resulting in recognition of the trial court's error and judgment for Appellants.

Appellants deem it a significant fact that Appellee has not disputed the recital of the proceedings in the trial court in any particular, but has chosen to quote piecemeal from the record in a manner which does not fairly reflect the true situation. Appellants hope that the brevity of this point answers the accusation that Appellants devoted themselves to this question in a way designed to submerge the merits of the case.

Appellants subscribe to the principle that there must be an end to litigation, but urge that such an end should be in accordance with the fundamental principles of justice.

Conclusion.

For all of the reasons above stated, Appellants respectfully submit that the judgment should be reversed with instructions to enter judgment in favor of Appellants.

Respectfully submitted,

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